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No. 88-

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1987

ARTHUR YOUNG & COMPANY,
Petitioner,

- v. -

ROBERT BURULL AND JEANNE BURULL,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

1. As a matter of law, may sanctions under rule 11 of the Federal Rules of Civil Procedure be denied -- as the Eighth and Ninth Circuits hold, in conflict with the rule in the First, Second, and Seventh Circuits -- when a trial court finds that plaintiffs and their counsel violated the rule by asserting patently frivolous claims?

2. As a matter of law, may sanctions under 28 U.S.C. § 1927 be denied when a trial court finds that plaintiffs' counsel filed an ancillary petition which counsel knew to be false and which "fueled this entire litigation;" filed pleadings that "ran directly counter to the court's direction;" unduly prolonged the trial; and engaged in numerous other instances of unprofessional conduct?

LIST OF PARTIES

The petitioner and defendant below is Arthur Young & Company, a general partnership of certified public accountants which has offices throughout the United States and which provides auditing, accounting, tax and management advisory services to its clients. The respondents and plaintiffs below are Robert and Jeanne Burull. First National Bank of Minneapolis was a defendant below and an appellant in the Eighth Circuit.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Arthur Young & Company ("Arthur Young") petitions this Court for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit, which is reported at 831 F.2d 788 (8th Cir. 1987), is reprinted in Appendix ("App.") A. The Memorandum and Order of the trial court (the "Sanctions Order") is reprinted in Appendix B. The trial court's first and second summary judgment decisions are reprinted in Appendices C and D, respectively.

JURISDICTION

The judgment of the Court of Appeals was entered on October 21, 1987. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Rule 11 of the Federal Rules of Civil Procedure provides, in relevant part:

> The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. . . . If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fees.

Section 1927 of Title 28, U.S.C., provides:

> Counsel's liability for excessive costs. Any attorney or other person admitted to conduct cases

in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorney's fees reasonably incurred because of such conduct.

STATEMENT OF THE CASE

I.

PROCEEDINGS IN THE TRIAL COURT THROUGH THE VERDICT

Arthur Young prevailed at trial on the claim of Robert and Jeanne Burull that, together with Barbara and Stephen Adams and First Bank of Minneapolis ("First Bank"), Arthur Young defrauded plaintiffs out of their stock in United States Satellite Services, Inc. ("USSS").

Plaintiffs twice survived summary judgment motions by Arthur Young only because of their claim that "a grand conspiracy between the Adams, First Bank and Arthur Young & Company . . . induced the Burulls to pledge their stock as collateral" for a loan First Bank made to USSS in May 1983. Order, April 25, 1985 (the "First Summary Judgment Decision"), App. C at C3-C4.[1]

On the third day of a thirty-five day trial plaintiffs stipulated that they had no factual basis for any claim against Arthur Young with respect to events before July 1983 and they withdrew their primary liability claim under section 10(b) of the Securities Exchange Act of 1934,

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[1] The trial court later denied a second summary judgment motion for essentially the same reasons.

15 U.S.C. § 78j(b). Thus, plaintiffs abandoned the very assertion that had narrowly saved them from summary judgment.

While Arthur Young's second summary judgment motion was *sub judice*, plaintiffs filed a second amended complaint and added new claims under sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 771(2) and q(a). The trial court dismissed those claims *sua sponte*. Order, April 3, 1986 (the "Second Summary Judgment Decision"), App. D. at D7-D8. It ruled that section 12(2), which is explicitly limited to claims by buyers of securities, could not provide any basis for a claim by the Burulls, who were sellers. *Id*. at D8. The court also cited the Eighth Circuit decisions over the last 20 years that leave no doubt but that section 17(a) does not provide a private claim for relief. *Id*. at D7-D8.[2]

II.

THE SANCTIONS MOTION IN THE TRIAL COURT AND THE COURT OF APPEALS DECISION

Following the jury verdict in its favor, Arthur Young moved for sanctions under Rule 11, 28 U.S.C. § 1927 and the court's inherent power. In its Sanctions Order the trial court castigated Karla Wahl, plaintiffs' principal counsel, and plaintiffs themselves.

- The court ruled that Mr. Burull and Ms. Wahl signed a bankruptcy petition for USSS which they knew were false and which "laid the foundation for

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[2] Plaintiffs did not argue -- until their brief on appeal -- that they were seeking the reversal of existing law.

the Burulls' present lawsuit. . . ." Sanctions Order, App. B. at B4. The court added, however, that, even though the false bankruptcy petition "fueled this entire litigation . . . [it] was falsified and filed in the bankruptcy court before this litigation even began" and therefore did not warrant sanctions. *Id.* at B12.

- The court concluded that the Burulls' second amended complaint, which added the section 12(2) and 17(a) claims, "ran directly counter to the court's direction that an amended complaint be filed to narrow the issues and . . . [e]qually important, the additional claims, on their face, lacked merit . . . ." *Id.* at B5. The court concluded that the section 12(2) and 17(a) claims were "the appropriate subject of a sanction." *Id.* at B11. However, because the court had dismissed those claims on its own initiative, it did not impose sanctions "despite the technical violation of Rule 11." *Id.*

- The court also rejected sanctions for the section 10(b) claim, but its reasoning is less clear. It declined to say there was no evidence to support plaintiffs' conspiracy claim despite its own comments as to the claim's implausibility, *id.* at B10-B11, and plaintiffs' concession on the third day of trial that they had no factual basis for the allegation.

- Finally, the court concluded that plaintiffs' counsel had repeatedly tried to elicit testimony about matters previously ruled inadmissible; had unduly prolonged the trial and caused defendants unnecessary delay, expense, and frustration; and had engaged in conduct "most unprofessional." *Id.*

at B6, B10, B12. Even with all of this, the trial court declined to impose sanctions under 28 U.S.C. § 1927.

Arthur Young and First Bank appealed the trial court's denial of sanctions to the United States Court of Appeals for the Eighth Circuit. Arthur Young argued that the trial court erred (1) in not imposing sanctions despite its finding that plaintiffs had violated rule 11 and (2) in not ruling that plaintiffs' counsel violated 28 U.S.C. § 1927, given its findings with regard to her conduct.

In a brief opinion, the Eighth Circuit rejected these arguments, as well as those of First Bank that the trial court should have sanctioned, under its inherent power, the conduct it found to have occurred. It ruled that, despite the trial court determination that rule 11 had been violated, sanctions were not appropriate because not every claim plaintiffs asserted ran afoul of rule 11. Although plaintiffs' counsel had not challenged the findings of misconduct on her part, the Eighth Circuit said that it would defer to the discretion of the trial court in declining to impose sanctions under section 1927. App. A at A5.

REASONS FOR GRANTING THE WRIT

I.

THE POLICY ISSUES AT STAKE

The 1983 amendment of rule 11 of the Federal Rules of Civil Procedure reflected the sense that something was terribly wrong with the manner in which parties and their counsel were conducting federal court litigation in the United States. The dramatic increase in litigation in the years preceding the amendment brought into the federal courts an increasing number of cases filed

only for their *in terrorem* effect on "deep pocket" defendants. Courts were inundated with groundless suits and motions; dilatory and unprofessional conduct was too often in evidence; and the courts had little real power to restrain any but the most egregious abuse.

Rule 11 was amended to provide the courts a potentially powerful weapon which they could use, along with 28 U.S.C. § 1927, to attack frivolous claims and improper conduct.[3] *See Zaldivar v. City of Los Angeles*, 780 F.2d 823, 829 n.5 (9th Cir. 1986); *Eastway Constr. Corp. v. City of New York* ("*Eastway I*"), 762 F.2d 243, 254 (2d Cir. 1985). Comment, *Litigant Responsibility: Federal Rule of Civil Procedure 11 and Its Application*, 27 B.C.L. Rev. 385, 405 (1986). The new rule (1) requires counsel to make some prefiling inquiry into both the factual and legal basis for any pleading or motion; (2) replaces the prior "good faith" test with a more stringent objective standard; and (3) mandates that sanctions must be imposed if the rule is violated.

In part in response to the dramatic increase in *in terrorem* litigation, motions for sanctions under rule 11 have begun to engulf the federal trial courts. With little definitive guidance, the lower courts have struggled with questions of how vigorously and in what manner they should impose sanctions. Through this burgeoning body of case law, increasing conflicts are developing, particularly as to rule 11 and as to the very issue presented by this petition.

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[3] Rule 11 applies to pleadings or motions filed; section 1927 relates generally to the conduct of counsel in litigation.

Amended rule 11 and section 1927 can serve the efficient functioning of the federal court system only if they are conscientiously applied and if litigants and their counsel know the consequences that will surely follow their violation. Trial courts defeat the purpose of rule 11 if, as here, they decline to impose sanctions where no prefiling inquiry, either legal or factual, occurred and where they have specifically found that rule 11 has been violated. Appellate courts send the wrong message to the bar of their circuits where, as here, they do not reverse denials of sanctions in instances where rule 11 and section 1927 have been clearly violated and do not in such instances stress the importance of compliance with them and the consequences for their violation.

This Court has never spoken to rule 11 and rarely to section 1927. Unlike those cases where the petitions for *certiorari* sought review of sanctions imposed under rule 11,[4] this case presents the Court with an opportunity to consider the denial of sanctions under rule 11 despite a finding that it had been violated and to resolve the conflict that is developing among the circuits. The issue is critically important, the errors of the lower courts grievous, and the time exactly right for this Court to send the message that rule 11 means what it says; that it must

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[4] *See, e.g., Eastway Constr. Corp. v. City of New York* ("*Eastway II*"), 821 F.2d 121 (2d Cir. 1987), *cert. denied*, 108 S. Ct. 269 (1987); *INVST Fin. Group, Inc. v. Chem-Nuclear Sys., Inc.*, 815 F.2d 391 (6th Cir. 1987), *cert. denied*, 108 S. Ct. 291 (1987); *Unioil, Inc. v. E.F. Hutton & Co.*, 809 F.2d 548 (9th Cir. 1986), *cert. denied*, 108 S. Ct. 85 (1987); *Bell v. Bell*, 801 F.2d 396 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1625 (1987); *Bader v. Itel*, 791 F.2d 672 (9th Cir. 1986), *cert. denied*, 107 S. Ct. 880 (1987); *Action Mfg., Inc. v. Fairhaven Textile Corp.*, 790 F.2d 164 (1st Cir.), *cert. denied*, 107 S. Ct. 188 (1986); *Tedeschi v. Smith Barney Harris Upman & Co.*, 757 F.2d 465 (2d Cir.), *cert. denied*, 474 U.S. 850 (1985).

be enforced vigorously; and that, if it is violated, sanctions will be imposed.

II.

THE MISAPPLICATION OF RULE 11 BELOW

That rule 11 was violated in this case is not in issue.[5] The trial court so found with respect to the claims under sections 12(2) and 17(a) and the court of appeals noted "the frivolousness of the allegation that Arthur Young had participated from the outset in a violation of § 10(b). . . ." App. A. at A3. The Eighth Circuit based its decision to affirm the denial of sanctions entirely on the fact that there were also nonfrivolous claims asserted and on the theory that sanctions are appropriate only when the entire pleading "itself is frivolous . . . ," *id.* at A4, quoting *Golden Eagle Distrib. Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1540 (9th Cir. 1986). By permitting frivolous claims if they are asserted along with nonfrivolous claims, the Eighth Circuit has invited litigants into a quagmire of rule 11 litigation over whether the "meritless elements of a complaint combine to render the pleading frivolous as a whole. . . ." App. A. at A4.

The Eighth Circuit may deride Arthur Young's "reductionist approach to Rule 11," *id.* at A4, but the rule itself clearly states that the court "*shall* impose . . . an appropriate sanction" where it has been violated and the "reductionist" approach has been adopted by the First, Second, and Seventh Circuits. *See Quiros v. Hernandez Colon*, 800 F.2d 1, 2-3 (1st Cir. 1986); *Tedeschi v. Smith*

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[5] Neither plaintiffs nor their counsel appealed the trial court's finding that rule 11 was violated.

Barney Harris Upman & Co., 757 F.2d 465, 466 (2d Cir.), *cert. denied*, 474 U.S. 850 (1985); *Frantz v. United States Powerlifting Fed'n*, Nos. 87-1149 & 87-1223, slip op. at 3, 5, 8 (7th Cir. Dec. 31, 1987); *Szabo Food Serv., Inc. v. Canteen Corp.*, 823 F.2d 1073, 1077 (7th Cir.), *petition for cert. filed*, 56 U.S.L.W. 3416 (U.S. Nov. 20, 1987) (No. 87-828).[6]

That a pleading or motion may contain nonfrivolous elements may be a factor in a trial court determination of "an appropriate sanction," *see* Rule 11, but, as the First, Second, and Seventh Circuits apparently recognize, that cannot defeat the application of rule 11 in

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[6] In *Frantz*, Judge Easterbrook, writing for the Seventh Circuit, said:

> Each claim takes up the time of the legal system and the opposing side. A single claim in an antitrust case may occasion the expenditure of hundreds or thousands of hours, as opposing counsel try to verify or refute the allegations and theories. Rule 18(a) permits the liberal joinder of claims, but each joined claim, potentially the basis of separate litigation, must have a foundation -- the same foundation it would have needed if the claims had been pursued separately. Just as evidence that Perkins is a thief does not justify an accusation that he is a murderer, so a colorable legal theory about boycotts of weight lifters does not excuse a baseless allegation about price fixing in the television business. Rule 11 applies to all statements in papers it covers. Each claim must have sufficient support; each must be investigated and researched before filing. See *Szabo*, 823 F.2d at 1080-82, 1082-84 (separately analyzing each claim in the complaint); *Hill v. Norfolk & Western Ry.*, 814 F.2d 1192, 1200 (7th Cir. 1987); *District No. 8 of Machinists v. Clearing*, 807 F.2d 618 623 (7th Cir. 1986). Contra, *Burull v. First National Bank of Minneapolis*, 831 F.2d 788 (8th Cir. 1987).

Slip Op. at 8-9.

the first instance. Any other result will undermine the stated purpose of rule 11 to "discourage dilatory or abusive tactics and help to streamline the litigation process by lessening frivolous *claims* or defenses." Fed. R. Civ. P. 11 advisory committee note (emphasis added). *Accord Westmoreland v. CBS, Inc.*, 770 F.2d 1168, 1180 (D.C. Cir. 1985).

III.

THE SANCTIONS MANDATED BY SECTION 1927 FOR THE ABUSIVE CONDUCT FOUND BELOW

Like rule 11, section 1927 is designed to curb litigation abuses but it is broader in scope because it is not tied to the signing of a pleading, motion or other paper. Section 1927 addresses the situation where "actions are extended unnecessarily by lawyers who exploit or abuse judicial procedures. . . ." *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 757 n.4 (1980). It provides for sanctions where counsel acts unreasonably or vexatiously or exhibits "a reckless disregard of the duty owed by counsel to the court." *Jaquette v. Black Hawk County*, 710 F.2d 455, 462 n.16 (8th Cir. 1983), quoting *United States v. Ross*, 535 F.2d 346, 349 (6th Cir. 1976).[7] The courts have available the developing law of what is objectively "reasonable" under rule 11 and should conclude that conduct is unreasonable and reckless if it is clear that competent counsel would act in a completely different manner. *See*,

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[7] In another context, "recklessness" has been described as "an extreme departure from the standards of ordinary care. . . ." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977).

e.g., Eastway I, 762 F.2d at 254; *Fisher v. CPC Int'l, Inc.*, 591 F. Supp. 228, 236-37 (W.D. Mo. 1984).

The trial court found that plaintiffs' pleading in this case was grounded on a knowingly false bankruptcy petition and it catalogued a series of violations of the standards of proper conduct at trial by plaintiffs' counsel. These include her vexatious waste of the time of all concerned by extending a relatively simple trial to an astonishing thirty-five trial days; by persisting in lines of questioning on subjects that the court had clearly ruled inadmissible; and by her general unprofessional conduct. Sanctions Order, App. B. at B6. It was an abuse of discretion to make these findings and then not impose sanctions. By any objective measure, that is unreasonable conduct in which competent counsel would not engage.

The error of the courts below presents this Court with an opportunity to speak to the bar on the importance of section 1927. It should make clear that section 1927 is measured by an objective standard of reasonable conduct and that, where counsel fails to meet that standard, they risk sanctions under this section. In this way, section 1927 and rule 11 will present a common, uniform standard by which both trial conduct and pleadings and motions will be judged. So applied, they will function together as effective weapons to deter improper conduct in federal court litigation.

CONCLUSION

"Misconduct, once tolerated, will breed more misconduct and those who might seek relief against abuse will instead resort to it in self-defense." Schwarzer, *Sanctions Under the New Federal Rule 11 -- A Closer Look*, 104 F.R.D. 181, 205 (1985). In this case the failure of

the lower courts to apply properly rule 11 of the Federal Rules of Civil Procedure and 28 U.S.C. § 1927 sends to litigants and their counsel a message of judicial tolerance of misconduct. Through reversal of the lower court decisions, this Court can send the proper message: that rule 11 and section 1927 must be vigorously applied to prevent dilatory, abusive, and improper conduct in federal court litigation.

Dated: January 19, 1988
New York, New York

Respectfully submitted,

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APPENDIX A

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

Nos. 87-5073, 87-5074

Robert and Jeanne Burull,	*	
	*	
Appellees,	*	
	*	
v.	*	
	*	
First National Bank of Minneapolis, a national banking association, and Arthur Young & Company, a Delaware corporation,	*	
	*	On Appeal from the
Appellants.	*	United States District
	*	Court for the District
Barbara and Stephen Adams,	*	of Minnesota
	*	
v.	*	
	*	
Robert and Jeanne Burull.	*	
	*	
Barbara and Stephen Adams,	*	
	*	
v.	*	
	*	
First National Bank of Minneapolis.	*	

Submitted: October 12, 1987

Filed: October 21, 1987

Before ARNOLD, Circuit Judge, HENLEY, Senior Circuit Judge, and BOWMAN, Circuit Judge.

This lawsuit returns to this Court on defendants' appeal from the District Court's[1] order denying their post-judgment motion for sanctions against plaintiffs under Fed. R. Civ. P. 11, 28 U.S.C. §1927, and the court's inherent power.

The odyssey of litigation in this case began in 1983, after the First National Bank of Minneapolis (the Bank) called a substantial loan to United States Satellite Systems (USSS), following an unfavorable audit of USSS by Arthur Young & Company. Plaintiffs Robert and Jeanne Burull, the founders of USSS, filed a bankruptcy petition to protect the company's assets, and the Bank responded by foreclosing on the Burulls' stock in the company. At the ensuing foreclosure sale, the Burulls' stock, amounting to 50 per cent of the voting shares, was purchased by Barbara Adams, who already owned the other half of the stock in USSS.

The Burulls felt cheated, and they filed this lawsuit against Arthur Young, the Bank, and Adams.[2] While the

[1] The Hon. Paul A. Magnuson, United States District Judge for the District of Minnesota.

[2] The Burulls settled with Adams at trial.

final version of their complaint raised twenty-three claims for relief under federal securities statutes and the commercial common law, each claim articulated some aspect of the Burulls' central contention that defendants had collaborated unlawfully to maneuver the Burulls out of their stock. After defeating defendants' motions for summary judgment and for a directed verdict, the Burulls lost their case before jury.[3] The successful defendants Arthur Young and First Bank then moved the District Court for attorneys' fees as sanctions under Rule 11, §1927, and the court's inherent power. The District Court denied the motion, and we affirm.

The Burulls' lawsuit, taken as a whole, was legally and factually substantial enough to reach a jury. Arthur Young argues, however, that it is entitled to Rule 11 sanctions because the Burulls' complaint contained several counts which were meritless as a matter of law,[4] and one count which would prove factually groundless.[5] The thrust of Arthur Young's appeal is that the District Court could not, as a matter of law, decline to impose sanctions once it had established that the Burulls had filed a pleading which incorporated frivolous grounds for relief.

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[3] We dismissed the Burulls' appeal from the judgment in Burull v. First National Bank of Minneapolis, 817 F.2d 56 (8th Cir. 1987).

[4] These counts claimed relief under §§12(2) and 17(a) of the 1933 Securities Act, provisions which were clearly inapplicable to this litigation.

[5] This count alleged that Arthur Young violated §10(b) of the 1934 Securities Exchange Act by conspiring with the other defendants from the outset to defraud the Burulls. At trial, plaintiffs' counsel stipulated that she had no evidence of Arthur Young's involvement until after the alleged conspiracy could have commenced.

We are not persuaded by Arthur Young's reductionist approach to Rule 11. Rule 11 directs sanctions "only when the 'pleading, motion or other paper' itself is frivolous, not when one of the arguments in support of a pleading or motion is frivolous." Golden Eagle Distributing Corp. v. Burroughs Corp., 801 F.2d 1531, 1540 (9th Cir. 1986). By definition, every unsuccessful complaint, at some level of analysis, contains either a flawed argument or an unsupported allegation. Whether meritless elements of a complaint combine to render the pleading frivolous as a whole is a "matter for the court to determine, and this determination involves matters of judgments and degree." O'Connell v. Champion International Corp., 812 F.2d 393, 395 (8th Cir. 1987).

While the court found that the Burulls' meritless claims, viewed in isolation, would be the appropriate subject of a sanction, it also found that their inclusion had no appreciable effect on the litigation of the Burulls' otherwise nonfrivolous lawsuit.[6] We see no reason to disturb the District Court's judgment here.

The Bank argues that the District Court was bound to award Rule 11 sanctions against the Burulls for having filed a false bankruptcy petition prior to this litigation. Although the bankruptcy of USSS certainly forms part of the background of this dispute, the Burulls' petition is not

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[6] The Burulls' claims based on §§12(2) and 17(a) were dismissed by the District Court on its own motion, only a week after plaintiffs filed their pleading. Defendants were never called on to address these claims in any pleading or brief. Similarly, the frivolousness of the allegation that Arthur Young had participated from the outset in a violation of §10(b) did not release Arthur Young from defending the Burulls' alternative claim that Arthur Young had aided and abetted co-defendant's alleged fraudulent scheme in violation of §10(b).

"a pleading, motion, or other paper" submitted as part of this lawsuit. See Adduono v. World Hockey Ass'n, 824 F.2d 617 (8th Cir. 1987). The District Court was within its discretion in denying the Bank's motion. The Bankruptcy Court has power to deal with this infraction. See Arkansas Communities, Inc. v. Mitchell, 827 F.2d 1219 (8th Cir. 1987).

Arthur Young and the Bank also argue that sanctions are warranted under §1927. They point to the District Court's repeated expressions of frustration with the trial tactics and techniques of the Burulls' counsel, and argue that the court incorrectly applied a subjective test of counsel's bad faith, overlooking her objectively vexatious conduct. We disagree. The District Court applied the correct standard when it could not "conclude with certainty that the Burulls or [their trial counsel] acted vexatiously or in bad faith." (Order p.13, emphasis added.) In any event, sanctions under §1927, unlike those under Rule 11, are discretionary, not mandatory. Over the last three years the District Court has become all too familiar with this grueling litigation, and we have no reason to interfere with its judgment that sanctions are inappropriate here. Nor do we see any abuse of discretion in the denial of sanctions under the court's inherent power. The order of the District Court is accordingly

Affirmed.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B

UNITED STATES DISTRICT COURT

DISTRICT OF MINNESOTA
THIRD DIVISION

Robert Burull and Jeanne Burull,
Plaintiffs,

v. Civil File No. 3-83-1564

First National Bank of Minneapolis,
a national banking association;
and Arthur Young and Company,
a partnership,

Defendants.

MEMORANDUM AND ORDER

Karla R. Wahl, Esq., 4717 IDS Center, 80 South Eighth Street, Minneapolis, Minnesota 55402,
and
John Bonner, III, Esq., 5775 Wayzata Blvd., Suite 745, Minneapolis, Minnesota 55416,
appeared on behalf of plaintiffs.

Roger J. Magnuson, Esq. and Jeffrey L. Sikkema, Esq., Dorsey & Whitney, 2200 First Bank Place East, Minneapolis, Minnesota 55402, appeared on behalf of First National Bank of Minneapolis.

Lawrence C. Brown, Esq., Faegre & Benson, 2300 Multifoods Tower, 33 South Sixth Street, Minneapolis, Minnesota 55402,
appeared on behalf of Arthur Young & Company.

Following approximately thirty-five days (35) of trial, on July 22, 1986, the jury returned a verdict in this matter, finding in favor of defendants First National Bank of Minneapolis (First Bank) and Arthur Young and Company (Arthur Young) on all claims of plaintiffs Robert and Jeanne Burull (Burulls). In accordance with the jury verdict, the court entered judgment in favor of First Bank and Arthur Young on July 28, 1986. The court is now confronted with various post-trial motions, including motions by First Bank and Arthur Young for an award of attorneys' fees and the imposition of sanctions against the Burulls and their attorneys. The other motions before the court include (1) the Burulls' motion for the imposition of sanctions on First Bank, Arthur Young, and their attorneys; (2) the motion of First Bank to require the Burulls to order an adequate trial transcript to support their appeal to the Eighth Circuit Court of Appeals; and (3) the motion of First Bank for an order requiring the Burulls to post a bond in the amount of $15,000.00 to ensure payment of costs on appeal.[1] The court held a hearing on the various motions on October 17, 1986.

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[1] Arthur Young similarly moved for an order requiring the Burulls to post a $15,000.00 bond for costs on appeal. During the interim, the Burulls revised their issues on appeal on at least two occasions and have dropped their appeal with respect to all issues relating to Arthur Young. Because Arthur Young is no longer involved in the appeal, the court need not address its motion for a bond on appeal.

SANCTIONS AND ATTORNEYS' FEES

First Bank and Arthur Young move separately for an award of attorneys' fees and the imposition of sanctions against the Burulls and their attorneys pursuant to the court's inherent power, Rule 11 of the Federal Rules of Civil Procedure, and 28 U.S.C. § 1927.[2] To support the motions, both defendants rely not only on the merits of the Burulls' asserted legal claims, but also on the alleged abuse of the judicial process by the Burulls and their counsel. More specifically, defendants contend that the Burulls and their counsel abused the judicial process by their conduct prior to, during, and following the litigation of this matter.

As the court has previously described, this action arises out of the rise and fall of United States Satellite Services, Inc. (USSS), a company founded by the Burulls. By this lawsuit, the Burulls contend that their business partner in USSS, Barbara Adams, together with First Bank, the lender, and Arthur Young, the accountant, collectively engaged in a course of conduct designed from the outset to defraud the Burulls out of their interest in USSS. The method allegedly chosen to achieve that goal

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[2] First Bank also bases its motion for attorneys' fees and sanctions on Minn. Stat. § 549.21 and the contract between the Burulls and First Bank. The court summarily rejects First Bank's argument that its attorneys' fees may be recovered pursuant to the parties' contract. The court finds that First Bank's attorneys' fees in this matter did not result from First Bank's efforts to enforce its rights within the meaning of the security agreements and the guarantees. With respect to an award of attorneys' fees under Minn. Stat. § 549.21, the court concludes that the analysis under the various other authorities is applicable and adequately addresses the relevant questions of bad faith, frivolous claims, and fraud upon the court. See Minn. Stat. § 549.21.

was to induce the Burulls to pledge their stock as collateral for the bank loans and then demand payment at an appropriate time so that Barbara Adams could obtain complete control of USSS.

Prior to initiating suit, the Burulls attempted to avoid or at least slow down First Bank's calling of the USSS loan by filing a bankruptcy petition on behalf of USSS. Mr. Burull, together with his personal attorney, Karla Wahl, signed the petition, avowing that he was authorized to do so by USSS and that the shareholders of USSS had unanimously adopted certain resolutions. Such resolutions in fact never existed and the evidence adduced at trial confirmed that Mr. Burull and his attorney knew such statements to be false. The filing of this bankruptcy petition laid the foundation for the Burulls' present lawsuit, limiting First Bank's options and forcing First Bank to foreclose on the USSS stock rather than pursuing the assets of the corporation.

Shortly thereafter, the Burulls filed the present lawsuit. In their original complaint, the Burulls asserted claims against Barbara Adams, her husband, Stephen Adams, First Bank, and Arthur Young arising primarily under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The Burulls also asserted claims of common law fraud, negligence, and commercial unreasonableness against First Bank and Arthur Young. The first step of the Burulls was to unsuccessfully move for a Temporary Restraining Order (TRO) and prevent the foreclosure sale by First Bank. To support their motion for a TRO, the Burulls contended, among other things, that the USSS stock had no value -- a contention later vigorously disputed by Burulls.

The Burulls' initial complaint withstood defendants' first motions for summary judgment. Although characterizing the allegations as rather implausible, the court could not conclude as a matter of law that the Burulls' securities claims would fail.

As the time for trial drew near, the court became concerned about the Burulls' theory for relief. In order to narrow the issues for trial and, at the very least, formulate a concrete theory of the case, the court requested that the Burulls submit a proposed verdict form and an amended complaint. For the first time in the history of the case, the Burulls indicated by special verdict questions that they intended to pursue civil RICO claims against the defendants. The civil RICO claims were not included in the Burulls' amended version of the complaint in accordance with the court's oral admonishment. Similarly, in their amended complaint, the Burulls asserted entirely new claims arising under §§ 12(2) and 17(a) of the Securities Act of 1933. The Burulls' addition of claims ran directly counter to the court's direction that an amended complaint be filed to narrow the issues and more concretely define the legal theories of the case. Equally important, the additional claims, on their face, lacked merit and the court accordingly dismissed such claims on its own motion.

Despite the weaknesses mentioned above, the Burulls' newly amended complaint once again survived defendants' renewed motions for summary judgment. In affirming its previous position, the court held that genuine issues of fact existed on the various claims under Section 10(b) and Rule 10b-5.

The case proceeded to trial on or about April 21, 1986 and finally concluded on July 22, 1986. Prior to the

presentation of evidence, the Burulls reached a settlement agreement with defendants Barbara and Stephen Adams, who were consequently dismissed from the action. Following the first few days of trial, the Burulls also agreed to dismiss certain claims against the remaining defendants, including all claims against Arthur Young for primary liability under the federal and state securities laws. During the course of trial, the court admonished the Burulls' counsel on various occasions, usually in relation to counsel's repeated attempts to elicit testimony about matters previously ruled inadmissible. All such attempts by counsel resulted in objections and bench conferences which were unnecessarily duplicative and time consuming.

Based upon the facts as highlighted and put into the context of this prolonged and frustrating litigation, the court is faced with the difficult task of determining whether or not the award of attorneys' fees and the imposition of sanctions against the Burulls and their attorneys are warranted. In considering this issue, the court recognizes its responsibility to detect and sanction abusive litigation practices in an effort to improve the judicial system. See Jaquette v. Black Hawk County, Iowa, 710 F.2d 455, 461-64 (8th Cir. 1983).

Courts are increasingly turning toward sanctions as a means of curbing litigation abuse and improving the litigation process. The imposition of sanctions, in turn, is often interwoven with the subject of shifting the burden of attorneys' fees. The power of a court to impose sanctions and shift the burden of attorneys' fees derives from a variety of sources, including the court's inherent authority, 28 U.S.C. § 1927, and Rule 11 of the Federal Rules of Civil Procedure.

A federal court possesses the power to access attorneys' fees against a party who has commenced or continued an action in bad faith, vexatiously, wantonly, or for oppressive reasons. Actors' Equity Association v. American Dinner Theatre Institute, 802 F.2d 1038, 1041 (8th Cir. 1986); Jaquette v. Black Hawk County, Iowa, 710 F.2d at 462; Oliveri v. Thompson, 803 F.2d 1265, 1272 (2d Cir. 1986). This power to access attorneys' fees, however, is subject to restrictive standards. A court should impose attorneys' fees "only when extraordinary circumstances or dominating reasons of fairness so demand." Actors' Equity Association v. American Dinner Theatre Institute, 802 F.2d at 1042 (citing Nepera Chemical, Inc. v. Sea-Land Service, Inc., 794 F.2d 688, 702 (D.C. Cir. 1986)). Similarly, court should not award attorneys' fees unless a party's claim is frivolous, unreasonable, or groundless. Actors' Equity Association v. American Dinner Theatre Institute, 802 F.2d at 1042

A court also has the power to assess excess costs and attorneys' fees against an attorney personally pursuant to 28 U.S.C. § 1927. This statutory authority provides that "[a]ny attorney . . . who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct." 28 U.S.C. § 1927. While courts have articulated various standards in interpreting § 1927, they have consistently required a rather high standard of fault. Generally, courts impose sanctions under § 1927 only when an attorney has acted in bad faith. See Oliveri v. Thompson, 803 F.2d at 1273; Dreiling v. Peugeot Motors of America, Inc., 768 F.2d 1159, 1165 (l0th Cir. 1985). See also Jaquette v. Black Hawk County, Iowa, 710 F.2d at 462. The court's authority under § 1927 reaches not only acts of bad faith in instituting litigation, but also bad faith conduct in

the course of litigation. See Lipsig v. National Student Marketing Corp., 663 F.2d 178, 181-82 (D.C. Cir. 1980) ("While the presence of merit in a claim or defense may well negate any notion of bad faith in its filing, it certainly cannot justify abuse of the judicial process in the methodology of its prosecution.") (emphasis in original).

Finally, a court may impose sanctions, including reasonable attorneys' fees, under Rule 11 of the Federal Rules of Civil Procedure. That rule provides in part

> Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney of record.... The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper, that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigations.... If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

Fed. R. Civ. P. 11.

In contrast to the rather restrictive standards governing the court's inherent power and § 1927, Rule 11 provides a more expansive standard for the imposition of sanctions and the awarding of attorneys' fees. Under Rule 11, subjective bad faith is not the touchstone for sanctions. An attorney's good faith no longer serves as a "safe harbor" against the imposition of sanctions. Instead, Rule 11 endorses an objective standard and imposes an affirmative duty on each attorney to conduct a reasonable inquiry into the viability of a pleading before it is signed. Zaldivar v. City of Los Angeles, 780 F.2d 823, 829-32 (9th Cir. 1986); Eastway Construction Corp. v. City of New York, 762 F.2d 243, 253-54 (2d Cir. 1985). Rule 11 sanctions are to be imposed against an attorney and/or his client when it appears that a pleading has been interposed for an improper purpose, or where, after reasonable inquiry, a competent attorney could not form a reasonable belief that the pleading is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law. Zaldivar v. City of Los Angeles, 780 F.2d at 830-32; Eastway Construction Corp. v. City of New York, 762 F.2d at 254.

Turning from the governing legal standards to the specific facts of the instant case, the court notes again that defendants seek sanctions not only on the basis of the Burulls' legal claims, but also on the conduct of the Burulls and their attorneys during the course of this litigation. As all parties are aware, this court has in no uncertain terms indicated its frustration with the litigation of this case. From the early stages of this suit, the court has voiced its concern over the plausibility of the Burulls' grand conspiracy claims which form the principal part of their lawsuit. Similarly, the court expressed concern over the manner in which the lawsuit was being conducted by

the Burulls and their counsel.[3] Indeed, as previously detailed, the court on various occasions admonished counsel concerning several aspects of trial tactics and technique. The frustration felt by the court and all parties involved was only increased by the prolonged trial. It is in this light that the court is called upon to address the question of sanctions.

The court addresses first the defendants' motions for sanctions and attorneys' fees as they relate to the frivolousness of the Burulls' claims for relief. The principal argument advanced by First Bank and Arthur Young with respect to this issue is that the Burulls' claims of securities fraud, based upon the alleged conspiracy or concerted action among the Adams, First Bank, and Arthur Young, had no basis in fact. More specifically, First Bank and Arthur Young contend that the Burulls failed to introduce any evidence to support such claims and that the primary claims of the Burulls consequently lacked merit and were frivolous.

Admittedly, this court characterized the Burulls' claims as implausible on more than one occasion. Nevertheless, the court rejected defendants' repeated efforts to dispose of such claims. Considering all the evidence

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[3] During the pretrial stages of this action, the Burulls were represented solely by Karla Wahl. Prior to trial, the court suggested and strongly encouraged Ms. Wahl to associate herself with additional counsel for the purpose of conducting the actual trial. Shortly thereafter, John Bonner, III became involved in the case as Burulls' trial counsel. Together, Ms. Wahl and Mr. Bonner conducted the trial on behalf of the Burulls. The court, at this time, commends Mr. Bonner on the professional manner in which he conducted himself during the trial of this matter. The court's reference to Burulls' counsel in this opinion excludes for the most part the actions of Mr. Bonner.

presented at trial, the court again declines to find that the Burulls' claims were plainly frivolous or without any factual foundation. Although the Burulls relied solely on circumstantial evidence to support their allegation of a conspiracy by the defendants, the court cannot say such evidence did not support their claim. Undoubtedly, the evidence and its inferences were weak at best and rejected by the jury. In considering sanctions, however, the court must avoid hindsight. On this basis, the court refuses to impose sanctions upon the Burulls or their attorney, Ms. Wahl, on the ground that their main claims for violations of § 10(b) of the Securities Exchange Act of 1934, Rule 10b-5, and the comparable state securities laws were frivolous. Additionally, the court cannot say that such claims were advanced for an improper purpose within the meaning of Rule 11

In addition to the claims arising under § 10(b) and Rule 10b-5, the Burulls by their amended complaint also asserted claims arising under §§ 12(2) and 17(a) of the Securities Act of 1933. As the court held in its Order dated April 2, 1986, these claims on their face lacked merit. Because Rule 11 requires a reasonable investigation and consideration of claims before including them in a complaint, such claims by the Burulls are the appropriate subject of a sanction. The problem the court faces, however, is that these claims were summarily dismissed by the court on its own initiative. Neither First Bank nor Arthur Young gave such claims serious consideration or devoted any significant time toward disposing of them. Under these circumstances, the court does not find sanctions warranted, despite the technical violation of Rule 11. Oliveri v. Thompson, 803 F.2d at 1280. This conclusion, however, in no way condones the conduct of counsel in including such meritless claims, especially in

light of the court's directions not to include additional claims for relief in the amended complaint.

The court next addresses the motions for sanctions and attorneys' fees as they relate to the conduct of the Burulls and their attorney during the course of this litigation. Because Rule 11, by its terms, applies only to a "pleading, motion, or other paper" signed by an attorney, these issues are more appropriately dealt with under the court's inherent authority and 28 U.S.C. § 1927.

The court has previously highlighted various conduct on the part of the Burulls and their attorney which the court and the defendants have found objectionable. Beginning with the pre-litigation filing of the bankruptcy petition and continuing through the post-trial filings, the trial tactics of the Burulls and Ms. Wahl have been most unprofessional on several occasions. The court finds particularly disturbing the false bankruptcy petition which, in effect, fueled this entire litigation. Such petition, however, was falsified and filed in the bankruptcy court before this litigation even began. As such, the court does not deem it conduct which would warrant sanctions in connection with the present litigation before this court.

With respect to the remaining activities and conduct which defendants contend constitute an abuse of the litigation process, the court finds itself constrained by the restrictive standards governing its inherent power to sanction and 28 U.S.C. § 1927. Without doubt, the trial tactics and techniques of the Burulls and their counsel have resulted in unnecessary delay, expense, and frustration to First Bank and Arthur Young. Nevertheless, the court cannot conclude with certainty that the Burulls or Ms. Wahl acted vexatiously or in bad faith in the

instituting or conducting of this lawsuit.[4] The motions for the imposition of sanctions and attorneys' fees of First Bank and Arthur Young is thus denied.

The court reiterates the difficult task presented by the defendants' motion for sanctions. Although the court concludes, after careful consideration, that sanctions are not warranted under the circumstances, it also emphasizes that it in no way condones the manner in which this lawsuit was conducted.

Before concluding, the court addresses the Burulls' motion for the imposition of sanctions on First Bank, Arthur Young, and their attorneys. To support their motion, the Burulls contend that they have incurred excessive costs, expenses, and attorneys' fees due to the alleged abusive motion practice of First Bank and Arthur Young. Specifically, the Burulls assert that First Bank and Arthur Young filed numerous motions which were designed solely to harass, intimidate, and unreasonably and vexatiously multiply the proceedings in this action. The court rejects this argument, finding that First Bank and Arthur Young did not interpose any motions for an improper purpose. The Burulls' motion for sanctions is thus denied.

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[4] First Bank relies upon the alleged perjurious trial testimony of the Burulls to support its motion for sanctions. The court is not inclined to rule on the veracity of the Burulls in the context of this motion. In any event, the court does not believe it appropriate to impose monetary sanctions on an attorney based upon a finding that her client is not worthy of belief. See Oliveri v. Thompson, 803 F.2d 1265, 1277-78 (2d Cir. 1986).

TRIAL TRANSCRIPT ON APPEAL

First Bank files this motion pursuant to Rule 10(b)(3) of the Federal Rules of Appellate Procedure for an order requiring the Burulls to provide a trial transcript for their appeal of this matter. The Burulls oppose First Bank's motion, contending that their appeal involves only a legal issue for which no trial transcript is needed.

The Burulls originally filed a Notice of Appeal which included four separate issues to be presented on appeal. One of the issues initially presented was whether the jury verdict was contrary to the evidence. Following their Notice of Appeal and accompanying statement of issues, the Burulls filed a certification that a transcript of the district court proceedings was not necessary. Subsequently, the Burulls modified their statement of issues on two separate occasions, dropping three of the four issues originally listed. The remaining issue is whether the court erred in failing to submit to the jury the Burulls' claim of the alleged breach of duty of good faith and fair dealing of First Bank. The Burulls submit that such issue is purely legal, requiring only a partial transcript of the court's charge conference.

The court must reject Burulls' argument on this point. The court necessarily considers this matter based upon its own notes and recollection. As such, the court cannot recite with absolute certainty the previously stated basis for its ruling. Implicit in that ruling, however, was the court's conclusion that the Burulls' claim for a breach of the duty of good faith and fair dealing against First Bank was not adequately supported by the evidence. A proper review of this issue on appeal thus requires a trial transcript which includes, at a minimum, that evidence

relevant to such issue. See Garnes v. Gulf & Western Manufacturing Co., 789 F.2d 637, 640 n.3 (8th Cir. 1986).

The court is not in a position to determine exactly what portion of the trial transcript is needed. While the court is somewhat reluctant to require the Burulls to designate the entire trial transcript, it has little choice in the absence of any designation whatever by the Burulls. As appellants, the Burulls bear the responsibility of providing an adequate record on appeal, including a transcript of all evidence relevant to their contentions. See Brattrud v. Town of Exline, 628 F.2d 1098, 1099 (8th Cir. 1980). Accordingly, the court will grant First Bank's motion to require the Burulls to provide a trial transcript on appeal. Specifically, the Burulls are ordered to designate all portions of the trial transcript which contain evidence relevant to the claim against First Bank for a breach of good faith and fair dealing.

BOND FOR COSTS ON APPEAL

First Bank's final motion is pursuant to Rule 7 of the Federal Rules of Appellate Procedure for an order requiring the Burulls and their attorneys to post a bond in the amount of $15,000.00 to ensure payment of costs and expenses on appeal. Included in the $15,000.00 amount of costs is First Bank's estimate of attorneys' fees to be incurred in connection with the appeal.

Appellate Rule 7 vests discretionary power in the district court to "require an appellant to file a bond or provide other security in such form and amount as it finds necessary to ensure payment of costs on appeal in a civil case." Fed. R. App. P. 7. The costs referred to, however, include only those costs which may be assessed against an unsuccessful litigant under Rule 39 of the

Federal Rules of Appellate Procedure and do not include attorneys' fees on appeal. In re American President Lines, Inc., 779 F.2d 714, 716 (D.C. Cir. 1985). For this reason, the court grants First Bank's request for a bond but reduces the amount to more accurately represent the likely costs to be incurred on appeal. The court in its discretion therefore orders the Burulls to file a bond in the amount of $2,000.00 to ensure the payment of First Bank's estimated costs on appeal.

Accordingly, IT IS ORDERED that:

1. The motion of defendant First National Bank of Minneapolis for an award of attorneys' fees and the imposition of sanctions against plaintiffs, Robert and Jeanne Burull, and their counsel is denied.

2. The motion of defendant Arthur Young and Company for an award of attorneys' fees and the imposition of sanctions against plaintiffs, Robert and Jeanne Burull, and their counsel is denied.

3. The motion of plaintiffs, Robert and Jeanne Burull, for an award of attorneys' fees and the imposition of sanctions against defendants, First National Bank of Minneapolis and Arthur Young and Company, is denied.

4. The motion of First National Bank of Minneapolis for an order requiring plaintiffs, Robert and Jeanne Burull, to provide a trial transcript for their appeal is granted and Robert and Jeanne Burull shall order all portions of the trial transcript which contain evidence relevant to the claim against First National Bank of Minneapolis for breach of the duty of good faith and fair dealing.

5. The motion of First National Bank of Minneapolis for an order requiring the plaintiffs, Robert and Jeanne Burull, to post a bond to ensure payment of costs and expenses on appeal is granted and Robert and Jeanne Burull shall post a bond in the amount of $2,000.00 to ensure payment of the costs and expenses of First National Bank of Minneapolis on appeal.

6. The motion of Arthur Young and Company for an order requiring the plaintiffs, Robert and Jeanne Burull, to post a bond to ensure payment of costs and expenses on appeal is denied as moot.

Dated: January 8 , 1987.

Paul A. Magnuson
United States District Judge

APPENDIX C

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

Robert Burull and Jeanne Burull,

Civil File No. 3-83-1564

ORDER

Plaintiffs,

v.

Barbara Adams, Stephen Adams,
First Bank of Minneapolis,
a National banking association,
and Arthur Young & Company,

Defendants.

A hearing was held before the undersigned on March 8, 1985 upon cross motions for summary judgment. Karla R. Wahl, Esq., appeared on behalf of plaintiffs. Roger J. Magnuson, Esq., and Jeffrey L. Sikkema, Esq., appeared on behalf of defendants.

This action arises out of the rather rapid rise and fall of an enterprise known as United States Satellite Services, Inc. (USSS), a company engaged in the business of operating master satellite antenna television systems. Robert and Jeanne Burull were the founders of USSS. In 1983 the Burulls negotiated a deal with Barbara Adams whereby Barbara Adams would arrange to provide financing to USSS and in return she would receive 50% of the voting shares of USSS.

On May 27, 1983 Robert Burull, Jeanne Burull and Barbara Adams entered into a Credit Agreement with the First Bank of Minneapolis (First Bank) whereby First Bank agreed to loan USSS up to $475,000. The Burulls and Barbara Adams were personally liable for the full amount of the loan. The loan was made by a series of promissory notes which permitted the First Bank to demand payment at any time without cause.

Shortly after the Credit Agreement was signed, a dispute erupted between the Burulls and Barbara Adams over the management of the company. In addition, the financial strength of USSS deteriorated rapidly. First Bank called the notes and when it was unable to collect from USSS it foreclosed upon the stock of the Burulls and Barbara Adams. The stock of USSS was sold at an auction to Barbara Adams for $10,000.

In this action the Burulls have brought suit against Barbara and Stephen Adams, First Bank, and Arthur Young & Company, the accounting firm that audited the books of USSS alleging, inter alia, violations of federal and state securities laws. First Bank and Arthur Young & Company have brought a series of motions for summary judgment. The Burulls have also brought a motion for summary judgment seeking to have this court hold, as a matter of law, that the foreclosure sale of USSS stock was commercially reasonable.

Rule 10b-5 of the Securities Exchange Act of 1934 provides in relevant part that:

> It shall be unlawful for any person, [to employ any device or engage in any practice which would operate as a fraud or make an untrue statement or

omission] in connection with the purchase or sale of any security.

17 CFR § 240.10(b)-05. Rule 10b-5 does not prohibit fraud in the abstract. It only condemns fraud if it occurs in connection with the purchase or sale of any security. See Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971). To determine whether First Bank committed any 10b-5 violation it is necessary to examine the conduct which plaintiffs allege constitutes the fraud and its relationship, if any, to the purchase or sale of any security.

The misrepresentations allegedly committed by First Bank fall into two categories. First, the Burulls allege that First Bank did not disclose that it had a substantial banking relationship with Stephen Adams, Barbara Adams' husband. Second, the Burulls allege that First Bank misrepresented the content of the Credit Agreement pursuant to which the Burulls received loans from First Bank. The purchase or sale of a security in the present case occurred either when First Bank sold the stock of USSS to Barbara Adams at its foreclosure sale or when the Burulls initially sold 50% of the voting stock of USSS to Barbara Adams.

The allegation that First Bank did not disclose its relationship with Stephen Adams is at the heart of the Burulls' claim against First Bank. Moreover, the failure of Arthur Young & Company to disclose its relationship with Stephen Adams is the material omission which is said to constitute the Rule 10b-5 violation of Arthur Young. The central premise behind the Burulls' 10b-5 cause of action is that there was a grand conspiracy between the Adams, First Bank and Arthur Young & Company whereby they all engaged in a course of conduct

which was designed from the outset to defraud the Burulls out of their investment in USSS. The method chosen to achieve that goal was to induce the Burulls to pledge their stock as collateral and then demand payment on the notes at an appropriate time so that Barbara Adams could obtain complete control over USSS.

In ruling on the motion of Arthur Young and First Bank, this court is mindful that this is a motion for summary judgment and summary judgment may not be granted unless it is clear that the non-moving party is not entitled to recover under any discernible circumstances. Any doubt about the facts must be construed in favor of the non-moving party. See Vette Company v. Aetna Casualty, 612 F.2d 1076 (8th Cir. 1980).

While this court would note that the purported 10b-5 violation against First Bank and Arthur Young & Company is, at best, an implausible explanation of the reason for the Burulls' financial misfortune, it cannot say that as a matter of law that the Burulls will be unable to prove the essential elements of a 10b-5 violation. The most persuasive argument in support of the defendants' motion is that the Burulls have not met the requirement that the fraud must be in connection with the purchase or sale of a security. This court cannot discern a true connection between the First Bank-Adams and Arthur Young & Company-Adams relationship and ultimate foreclosure sale in which the Burulls lost their stock. However, to the extent the plaintiffs can prove that the entire series of events, from the original loan transaction through the foreclosure sale, was a pre-planned conspiracy to defraud the plaintiffs of their investment in USSS, the court cannot say as a matter of law that their claim must fail. Accordingly, the court will deny the motions of

Arthur Young & Company and First Bank for summary judgment on the federal securities claim.

First Bank and Arthur Young & Company have also made a series of motions for summary judgment on the state law claims asserted by the plaintiffs. To the extent those claims arise out of the identical transaction as the federal securities claim and contain many of the same essential elements, this court's previous discussion is incorporated by reference and the court will deny those motions.

The plaintiffs have also brought a motion for summary judgment seeking to have this court hold, as a matter of law, that the sale of the Burulls' stock by First Bank was commercially unreasonable. The question of whether a sale was commercially reasonable is not a question which can readily be decided on a motion for summary judgment based upon the record presently before the court.

For the reasons stated above, IT IS ORDERED that:

1. All motions for summary judgment are denied.

Dated: April 23, 1985

Paul A. Magnuson
United States District Judge

APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

Robert Burull and Jeanne Burull,

Plaintiffs,

Civil File No. 3-83-1564

MEMORANDUM AND ORDER

v.

Barbara Adams, Stephen Adams, First Bank of Minneapolis, a National banking association, and Arthur Young & Company,

Defendants.

Karla R. Wahl, Esq. 4717 IDS Center, 80 South Eighth Street, Minneapolis, Minnesota 55402, and John Bonner, III, Esq. 5775 Wayzata Blvd., Suite 745, Minneapolis, Minnesota 55416, appeared on behalf of plaintiffs.

Joseph W. Anthony, Esq., Fruth & Anthony, P.A., 1350 International Centre, 900 Second Avenue South, Minneapolis, Minnesota 55402, appeared on behalf of Barbara and Stephen Adams.

Roger J. Magnuson, Esq. and Jeffrey L. Sikkema, Esq., Dorsey and Whitney, 2200 First Bank Place East, Minneapolis, Minnesota 55402, appeared on behalf of First Bank of Minneapolis.

Lawrence C. Brown, Esq., and Carol H. Hearn, Esq., Faegre & Benson, 2300 Multifoods Tower, 33 South Sixth Street, Minneapolis, Minnesota 55402, appeared on behalf of Arthur Young & Company.

This matter comes before the court on the renewed motions for summary judgment of defendants First Bank of Minneapolis (First Bank) and Arthur Young & Company (Arthur Young). In addition, plaintiffs renew their motion for summary judgment on their claim that the foreclosure sale of stock was commercially unreasonable. The court heard oral arguments on the motions on March 14, 1986.

The essential facts underlying this dispute have been set forth in the court's previous Order of April 23, 1985 and need not be repeated in detail here. For purposes of the present motions, it is sufficient to note that plaintiffs, Robert and Jeanne Burull, by their Second Amended Complaint allege violations of the securities laws' anti-fraud provisions on the part of the several defendants. The alleged violations relate to two separate "sales" by the Burulls of their shares of stock in United States Satellite Services, Inc. (USSS): (1) the May 1983 sale of shares to defendants Barbara and Stephen Adams and the pledge of shares by Burulls to First Bank; and (2) the December 1983 sale of Burulls' stock to Adams as a result of foreclosure action by First Bank.

In an Order dated April 23, 1985, the court denied the defendants' initial motions for summary judgment, finding that it could not conclude as a matter of law that the Burulls would be unable to prove the essential elements of a Rule 10b-5 violation. First Bank and Arthur Young now renew their motions for summary judgment,

contending primarily that Burulls cannot establish the "in connection with" requirement of a Rule 10b-5 claim. For the reasons stated below, the court affirms its earlier position and denies the defendants' renewed motions for summary judgment.

Initially, the court notes that Burulls' Rule 10b-5 claims against First Bank arise not only from the forced sale of stock to Adams in December 1983, but also from the May 1983 pledge of stock to First Bank. While First Bank vigorously contends that such pledge of stock was not a "sale" within the meaning of Rule 10b-5, the court must reject that argument. In Rubin v. United States, 449 U.S. 424, 431 (1981), the Supreme Court held that a pledge of stock was a "sale" for purposes of § 17(a) of the Securities Act of 1933. In Marine Bank v. Weaver, 455 U.S. 551 (1982), the Court stated that Rubin's holding extended to claims under § 10(b) of the Securities Act of 1934:

> The Court of Appeals also concluded that the pledge of a security is a sale [within § 10(b)], an issue on which the federal Circuits were split. We held in Rubin v. United States, 449 U.S. 424, 101 S. Ct. 698, 66 L. Ed. 2d 633 (1981), that a pledge of stock is equivalent to a sale for the purposes of the antifraud provisions of the federal securities laws. Accordingly, in determining whether fraud may have occurred here "in connection with the purchase or sale of any security," the only issue now before the Court is whether a security was involved.

455 U.S. at 554 n. 2 (emphasis original). On the basis of the Supreme Court's statement, the court must reject First Bank's position on this issue and conclude that the Burulls' pledge of USSS stock to First Bank constituted a

"sale" of a security under Rule 10b-5. See Head v. Head, 759 F.2d 1172, 1174-75 (4th Cir. 1985); Chemical Bank v. Arthur Andersen & Company, 726 F.2d 930, 940 (2d Cir.), cert. denied, ____ U.S. ____, 105 S. Ct. 253 (1984).

In their renewed motion for summary judgment, First Bank and Arthur Young focus their attention on the Rule 10b-5 requirement that the alleged fraud be "in connection with the purchase or sale of any security." These defendants rely upon the Second Circuit's restrictive reading of that requirement in Chemical Bank v. Arthur Andersen & Company, 726 F.2d 930 (2d Cir.), cert. denied, ____ U.S. ____, 105 S. Ct. 253 (1984).

Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder proscribe fraud "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. For the most part, the "in connection with" requirement has been liberally read by the courts. In reliance upon language of the Supreme Court in Superintendent of Insurance of New York v. Bankers Life & Casualty Co., 404 U.S. 6 (1971), lower courts have generally held that the connection requirement will be satisfied if the alleged fraud merely "touches" the purchase or sale. See In re Catanella and E. F. Hutton and Co. Securities Litigation, 583 F.Supp. 1388, 1408 (E.D. Pa. 1984) and cases cited therein.

In Chemical Bank v. Arthur Andersen & Co., supra, the case relied upon by defendants, the Second Circuit established a more restrictive application of the "in connection with" requirement of Rule 10b-5. In that case, Frigitemp Corporation arranged a bank loan for its subsidiary, Frigitemp guaranteed Elsters' promissory note and pledged as security 100% of Elsters' stock. Following Frigitemp's bankruptcy, the lending banks brought a Rule

10b-5 action against Frigitemp's accountant, alleging they had relied on falsified financial statements when extending the loan. The Second Circuit held that the misrepresentations were not made in connection with the pledge of Elsters' stock because the pledge was totally unrelated to the false financial statements of Frigitemp. Id., 726 F.2d at 944-45. Those facts are clearly distinguishable from the present case, where the alleged misrepresentations by First Bank are related to the initial pledge of stock to First Bank.

In addition, the court finds the "in connection with" element satisfied with respect to the foreclosure sale of Burulls' stock. Admittedly, broadly read, Chemical Bank stands for the proposition that Rule 10b-5 does not apply in cases where the misrepresentations do not pertain to the securities themselves. Id., 726 F.2d at 943. The facts of that case, however, do not support such a broad reading and subsequent courts have not applied the rule announced in Chemical Bank so restrictively. See Angelastro v. Prudential-Bache Securities, Inc., 764 F.2d 939, 942-46 (3rd Cir.) cert. denied, 106 S. Ct. 267 (1985). Moreover, the court believes that the case of Teltronics Services, Inc. v. Anaconda-Ericsson, Inc., 587 F.Supp. 724 (E.D.N.Y. 1984), aff'd on other grounds, 762, F.2d 185 (2d Cir. 1985) is inapposite. While that court dismissed a Rule 10b-5 claim founded on similar conspiracy allegations, the court found that the forced sale of securities was not integral to the alleged fraudulent scheme to plunge the plaintiff corporation into bankruptcy. That is not the situation in this case, for the foreclosure sale of USSS stock is at the heart of the defendants' scheme, as alleged by Burulls.

As the court noted in its previous order, the alleged conspiracy on the part of the defendants is rather

implausible. In this respect, the Burulls have a heavy burden to bear in order to substantiate their Rule 10b-5 claims. Nevertheless, the court must affirm its earlier position that it cannot conclude as a matter of law that the Burulls' Rule 10b-5 claims must fail.

The court also notes that the Burulls' Second Amended Complaint includes claims of aiding and abetting against First Bank and Arthur Young. To establish aiding and abetting liability under § 10(b) and Rule 10b-5, three requirements must be satisfied: (1) the existence of a securities law violation by the primary party (as opposed to the aiding and abetting party); (2) "knowledge" of the violation on the part of the aider and abettor; and (3) "substantial assistance" by the aider and abettor in the achievement of the primary violation. Metge v. Baehler, 762 F.2d 621, 624 (8th Cir. 1985), cert. denied, 106 S.Ct. 798 (1986) (citing Stokes v. Lokken, 644 F.2d 779, 782-83 (8th Cir. 1981)). These individual requirements are not to be considered in isolation, but rather in relation to one another, especially the requirements of knowledge or scienter and substantial assistance. Id. The court has reviewed the files and records in this case and believes that genuine issues of material fact exist with respect to the claims of aiding and abetting under § 10(b) and Rule 10b-5 which preclude summary judgment.

The court also has before it Burulls' renewed motion for summary judgment seeking to have the court hold, as a matter of law, that the sale of Burulls' stock by First Bank was commercially unreasonable. Specifically, Burulls contend that summary judgment is appropriate since reasonable persons can only reach a conclusion that the sale was commercially unreasonable. This court disagrees under the present circumstances and affirms its

previous order that the issue of commercial reasonableness cannot be readily decided on a motion for summary judgment.

Before concluding, the court addresses additional alleged violations of the anti-fraud provisions of the securities laws which the Burulls raise in their Second Amended Complaint. Specifically, the court on its own motion, addresses the legal sufficiency of the Burulls' claims arising under §§ 12(2) and 17(a) of the Securities Act of 1933. Because the Burulls just recently filed their Second Amended Complaint, the defendants have not had an opportunity to file any motions with respect to the additional claims under §§ 12(2) and 17(a). Nevertheless, the court on its own motion may dismiss a claim under Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim upon which relief can be granted. Martin-Trigona v. Stewart, 691 F.2d 856, 858 (8th Cir. 1982), citing 5C Wright & A. Miller, Federal Practice and Procedure, § 1357 at 593 (1969). The court believes such action is appropriate in this case given the fact that the matter is scheduled to go to trial in the near future. Moreover, the court is somewhat disturbed insofar as it understood that Burulls' Second Amended Complaint was not for the purpose of including additional claims. Apparently the court did not make itself clear for the Burulls added claims under §§ 12(2) and 17(a).

In Counts Two, Five, Ten, and Thirteen of their Second Amended Complaint, the Burulls allege that the defendants' conduct violated § 17(a) of the Securities Act of 1933. Burulls' claims under that section, however, must fail. Under the present state of law in the Eighth Circuit, § 17(a) provides no private cause of action and Burulls' claims under that section must be dismissed. Greater Iowa Corp. V. McLendon, 378 F.2d 783, 788-90 (8th

Cir. 1967); Shull v. Dain, Kalman & Quail, Inc., 561 F.2d 152, 155 (8th Cir. 1977), cert. denied, 434 U.S. 1086 (1978).

Burulls' claims arising under § 12(2) of the Securities Act of 1933 similarly fail and must be dismissed.[1] It is undisputed that the Burulls are the sellers of securities with respect to all transactions at issue in this action. Consequently, the Burulls do not have a remedy under § 12(2), since that section provides a remedy only to defrauded purchasers of securities. See Hiduchenko v. Minneapolis Medical & Diagnostic Center, 467 F. Supp. 103, 106 (D. Minn. 1979) (Alsop, C.J.); Darvin v. Bache Halsey Stuart Shields, 479 F.Supp. 460, 463 (S.D.N.Y. 1979). See also Greater Iowa Corp. v. McLendon, 378 F.2d at 789.

Accordingly, IT IS ORDERED that:

1. The renewed motions for summary judgment of defendants, First Bank of Minneapolis and Arthur Young & Company, are denied.

2. The renewed motion for summary judgment of plaintiffs, Robert and Jeanne Burull, is denied.

3. The court on its own motion dismisses the claims of plaintiffs, Robert and Jeanne Burull, arising under § 17(a) and § 12(2) of the Securities Act of 1933 and Counts Two, Three, Five, Six, Nine, Ten, Twelve, and Thirteen of plaintiffs' Second Amended Complaint are hereby dismissed.

Dated: April 2, 1986.

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[1] Such claims include Counts Three, Six, Nine, and Twelve of the Second Amended Complaint.

Paul A. Magnuson
United States District Judge

Supreme Court, U.S.
FILED
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CLERK

No. 87-1216

IN THE
Supreme Court of the United States
October Term, 1987

ARTHUR YOUNG & COMPANY,
Petitioner,

v.

ROBERT BURULL and JEANNE BURULL,
Respondents.

ON CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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STATEMENT OF THE CASE

The Eighth Circuit opinion, reproduced at pages A-2 through A-5 of the Petition,[1] contains a concise statement of the relevant facts and the proceedings in the district court, 831 F.2d 788 (8th Cir. 1987). The Eighth Circuit opinion is more accurate, dispassionate, and balanced than Petitioner's statement.[2]

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[1] All citations to the record are to the appendix to the Petition.

[2] The misleading nature of Petitioner's statement of the case is reflected in Petitioner's statement that the 10b-5 claim Mr. and Mrs. Burull asserted against Arthur Young was the only claim that permitted the Burulls to escape Arthur Young's two summary judgment motions. Petitioner, at 3. Arthur Young continues this argument by stating that on the third day of trial the Burulls stipulated to withdrawing their primary liability claim under §10(b) of the 1934 Securities Exchange Act and Rule 10b-5 because they had no evidence that Arthur Young had any involvement "with respect to events before July 1983" (*id*).

But dismissal of the primary liability claim left intact Burulls' separate claim that Arthur Young had aided and abetted a 10b-5 violation. Court of Appeals, at A-4, n.6. Moreover, the July 1983 date is of no legal significance, since one can be a member of a conspiracy even though one was not part of the scheme from the beginning. *United States v. Burchinal*, 657 F.2d 985 (8th Cir. 1981). In addition, the withdrawal of a claim does not mean that there is no evidence to support the claim. Furthermore, there is no evidence in the record that supports a finding that this claim was not well grounded in fact and warranted by existing law when this pleading was signed or at the moment of withdrawal or at any other time. As Petitioners have failed to provide a transcript of the proceedings, the record presumptively supports the lower court's decision. *See, e.g., Farrar v. Cain*, 756 F.2d 1148, 1152 (5th Cir. 1985).

Remarkably, Petitioner omits that in addition to surviving two summary judgment motions, Burulls also survived Petitioner's motion for a directed verdict. Even with hindsight, the trial judge was unable to conclude when considering Petitioner's post-trial motions, "that the Burulls' claims were plainly frivolous or without any factual foundation" (Appendix to Petition, at B-11). Common law claims were also submitted to the jury.

REASONS FOR DENYING THE WRIT

Stripped of its verbiage, the petition requests this court to address a very simple question: whether the district court and the court of appeals erred in considering its motions for sanctions under Fed. R. Civ. P. 11 and 28 U.S.C. §1927. The basis of Petitioner's Rule 11 contention is that the final version of the Burulls' complaint contained two counts (in a multiple count pleading) asserted against Arthur Young that were legally deficient. This court denied a similar request for review of denial of sanctions in a case that contained both colorable and non-colorable claims, *Oliveri v. Thompson*, 803 F.2d 1265, 1280 (2d Cir. 1986), *cert. denied sub nom. County of Suffolk v. Graseck*, 107 S.Ct. 1373 (1987), and should also deny this petition.[3] The basis of Petitioner's claim to entitlement to sanctions under 28 U.S.C. §1927 is that the Burulls' case was fueled by Respondent Robert Burull's filing a faulty bankruptcy petition and on the ground of generalized trial misconduct by counsel. The Petition should be denied for the following reasons.

I. THE COMPLAINT DID NOT VIOLATE RULE 11.

Petitioner Arthur Young falsely states "[t]hat rule 11 was violated in this case is not in issue." Petition, at 9. The Court of Appeals found that sanctions "under Rule 11 . . . are . . . mandatory"—and, affirmed the denial of sanctions by the district court. Court of Appeals, at A-5. *See also Thomas v. Capital Security Services, Inc.*, Slip. op., No. 86-4480 (5th Cir. January 21, 1988) (*en banc*) (sanctions under Rule 11

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[3] *County of Suffolk v. Graseck*, 107 S.Ct. 1373 (1987), presented the question to this Court: "Is court of appeals in conflict with all of the other circuits in ignoring the plain language of Fed. R. Civ. P. 11 by fashioning 'de minimus' exception?" *Id.*, at 55 U.S.L.W. 3588 (1987).

mandatory). The district court found only a "technical" violation of Rule 11 (citing *Oliveri v. Thompson*, 803 F.2d 1265, 1280 (2d Cir. 1986), *cert. denied sub nom., County of Suffolk v. Graseck*, 107 S.Ct. 1373 (1987)), which would not support Rule 11 sanctions. Hence, no Rule 11 violation has been found by the lower courts.

A. A Meritorious Complaint That Contains Counts That Are Dismissed Sua Sponte Before Any Response Is Made Does Not Violate Rule 11 Under The Facts Of This Case.

The final version of the complaint contained 23 counts. Included in the counts alleged against Arthur Young were counts stating that Arthur Young acted in violation of §§12 (2) and 17(a) of the Securities Act of 1933 (15 U.S.C. 77(a) et seq.). It is a matter of dispute in the circuit courts of appeal whether §17(a) can be asserted by private litigants. Hazen, THE LAW OF SECURITIES REGULATION §13.13 (1985) ("Most courts that have heard the question have implied a section 17(a) remedy, although there is an increasing body of substantial authority to the contrary [footnote omitted]"). The Eighth Circuit has held that §17(a) provides no private remedy. Section 12(2) applies only to purchasers of securities; Burulls were sellers of securities. These counts were "dismissed by the District Court on its own motion, only a week after plaintiffs filed their pleading. Defendants were never called on to address these claims in any pleading or brief." Court of Appeals, at A-4. Moreover, the offending parts of the pleading were dismissed during the period in which the Burulls had the absolute right to withdraw the pleading. Fed. R. Civ. P. 15(a).

The Court of Appeals in refusing to find a Rule 11 violation held: "Whether meritless elements combine to render the

pleading frivolous as a whole is a 'matter for the court to determine, and this determination involves matters of judgments and degree.' *O'Connell v. Champion International Corp.*, 812 F.2d 393, 395 (8th Cir. 1987)." Court of Appeals, at A-4. Applying this abuse of discretion standard to this case, the Court of Appeals found that the Burulls' §§12(2) and 17(a) claims, "viewed in isolation would be the appropriate subject of a sanction", but the claims when integrated with the rest of the complaint did not so infect the complaint as to render the pleading not well grounded in fact and warranted by law. *Id.* This holding, as shown immediately below, is supported by decisional law. Any other holding would defeat the purpose of Rule 11 by creating satellite litigation in virtually every lawsuit in which there is a "winner" and "loser."

Rule 11 does not mandate that whenever a pleading contains an error that the rule is violated and sanctions must be granted. As stated in *Golden Eagle Distributing Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1540-41 (9th Cir. 1986):

> Moreover, the Rule does not apply to the mere making of a frivolous argument. The Rule permits the imposition of sanctions only when the "pleading, motion, or other paper" itself is frivolous, not when one of the arguments in support of a pleading is frivolous. . . . In short, the fact that the court concluded that one argument or subargument in support of an otherwise valid motion, pleading, or other paper is unmeritorious does not warrant finding that the motion or pleading is frivolous or that the Rule has been violated.

Accord Baden v. Craig-Hallum, Inc., 646 F.Supp. 483, 493 (D. Minn. 1986); *Oliveri v. Thompson*, 803 F.2d 1265, 1280 (2d Cir. 1986), *cert. denied sub nom. County of Suffolk v. Graseck*, 107 S.Ct. 1373; *Rateree v. Rocket*, 630 F.Supp. 763, 778 (N.D. Ill. 1986).

The Third Circuit in *Gaiardo v. Ethyl Corp.*, No. 875248, slip. op. at 10-11, (Dec. 14, 1987) (per Judge Weis) recently applied the *Golden Eagle* analysis:

> As we emphasized in *Morristown Daily Record Inc. v. Graphic Communications Union Local 8N*, No. 875321, slip op. at 2 n.1 (3d Cir. Oct. 29, 1987), when issues are close, the invocation of Rule 11 borders on the abusive: "We caution litigants that Rule 11 is intended for only exceptional circumstances." Nothing in the language of the Rule or the Advisory Committee Notes supports the view that "the Rule empowers the district court to impose sanctions on lawyers simply because a particular argument or ground for relief contained in a nonfrivolous motion is found by the district court to be unjustified." *Golden Eagle Distrib. Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1540-41 (9th Cir. 1986).

The Petitioner has identified no cases that are in conflict with this authority. Petitioner cites *Tedeschi v. Smith Barney, Harris Upham & Co.*, 757 F.2d 465, 466 (2d Cir.), *cert. denied*, 474 U.S. 850 (1985), as in conflict. *Tedeschi* is readily distinguished on its facts, as that case involves a plaintiff and his attorney bringing an action that was revealed to be predominated by frivolous claims in an arbitration hearing. The district court dismissed all five of the plaintiffs' claims before trial, finding that the action was instituted in bad faith without legal or factual support for any of the claims except one, and that claim was barred by the statute of limitations. *Tedeschi v. Smith Barney, Harris Upham & Co., Inc.*, 579 F.Supp. 657, 661 (S.D.N.Y. 1984). This is in contrast to this case where the district court could not find that the "Burulls' claims were plainly frivolous or without factual foundation" (B-11).

Quiros v. Hernandez Colon, 800 F.2d 1, 2-3 (1st Cir. 1986), cited by Petitioner, as in conflict, is not in conflict. *Quiros* affirmed the denial of attorney's fees under 42 U.S.C. §1988 to a prevailing defendant. The Court stated in the context of the Civil Rights Attorney's Fees Act that it was "reluctant to adopt a rule requiring a court to engage in such fine tuning that it must award fees as to an insubstantial claim even though another claim was more substantial and perhaps even prevailed." *Id.* at 2. In *Quiros* the non-prevailing party had fees assessed against him under Rule 11. This award was not appealed. Accordingly, no Rule 11 issue was before the First Circuit.

The Seventh Circuit has developed a line of cases cited by Petitioner that at first appears in conflict with the cases just cited. Petitioner, at 9-10. *See Szabo Food Serv. Inc. v. Canteen Corp.*, 823 F.2d 1073, 1077 (7th Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3416 (Nov. 20, 1987) (No. 87-828). These cases are not in conflict as Judge Easterbrook, a moving force behind Rule 11 jurisprudence in the Seventh Circuit, would seemingly confine Rule 11 sanctions to "serious" cases and would not apply the Rule where the motion for sanctions is "foolish." *Szabo*, at 1084.[4]

If the rule were otherwise, every pleading peccadillo would violate Rule 11 and sanctions thereby mandated. The absurdity of this reductionist approach can be revealed by way

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[4] *Szabo* was remanded to determine whether the district court erred in failing to sanction. Judge Cudahy dissented stating this remand "opens new vistas for litigation . . . that will add more to our [appellate] burden than sanctions for 'objectively frivolous' cases will take away. 823 F.2d at 1086.

of an example. A pleading is filed, determined by counsel to be legally and/or factually deficient, is then withdrawn by counsel before receipt by the opposing party. Under Petitioner's scenario, this pleading would be subject to *mandatory* sanctions.

If Petitioner's argument were self-directed, its own answer violates Rule 11 by averring that the Burulls' complaint failed to state a claim upon which relief may be granted. As the Burulls' complaint was sufficient to get to the jury, a *prima facie* case was presented and Petitioner's answer claiming that the Burulls failed to state a claim upon which relief can be granted was neither supported by law nor by the developed facts.

As observed by Professor Nelken, *Sanctions Under Amended Federal Rule 11—Some "Chilling" Problems in the Struggle Between Compensation and Punishment*, 74 GEO. L. J. 1313 1328 (1986):

> The widely assumed right of a defendant to put a plaintiff to his proof is not supported by the Federal Rules. Indeed, Rule 8(b) permits a general denial only "subject to the obligations set forth in Rule 11"; frivolous answers violate rule 11 no less than frivolous complaints. Can a defense lawyer, any more than plaintiff's lawyer, take her clients' word in preparing pleadings?
>
> Similarly, the common practice of reciting a laundry list of affirmative defenses should be closely scrutinized under rule 11. . . . If plaintiffs begin to challenge the factual and legal adequacy of defendants' pleadings under rule 11, the use of sanctions will profoundly affect the "game" of litigation [footnotes omitted].

As the source of Rule 11 is Equity Rule 24, Equity Rules of 1842,[5] and amended Rule 11 builds on equity practice,[6] a Rule 11 movant seeks equity and must be free of unclean hands.[7]

B. Rule 11 Does Not Apply To *De Minimis* Violations.

If Respondents violated Rule 11 in this case by pleading one claim that was not recognized in the Eighth Circuit but is recognized elsewhere[8] and by pleading a count that was legally deficient because the law provides a remedy for purchasers of securities and not sellers, the violation was *de minimis* only and, accordingly, the violation does not support a sanction award under Rule 11.

Where a pleading is in error and that error involves neither significant litigant expense nor significant expenditure of judicial time, sanctions are not warranted, let alone appellate review. In *Oliveri v. Thompson*, 803 F.2d 1265, 1280 (2d Cir. 1986), *cert. denied sub nom. County of Suffolk v. Graseck*, 107 S.Ct. 1373 (1987), Judge Pratt writing for the Second Circuit found that a complaint that contained both claims of merit and deficient claims was in technical violation of Rule 11, but since the infraction was *de minimis* sanctions were not mandated, at least, as here, where the parties have not spent any significant time on the claims. *See also Baden v. Craig-Hallum, Inc.*, 646 F.Supp. 483, 493 (D. Minn. 1986). This is not to say, as suggested in the Petition at 9, that the

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[5] *See* Risinger, Honesty in Pleading and Its Enforcement: Some "Striking" Problems with Federal Rule of Civil Procedure 11, 61 Minn. L. Rev. (1976).

[6] Fed. R. Civ. P. 11 advisory committee's note.

[7] In denying Rule 11 sanctions, Judge Shadur remarked, "defendants' . . . Rule 11 motion may call into play the well-known legal proposition that people who live in glass houses shouldn't throw stones. *Rateree v. Rockett*, 630 F.Supp. 778, n.26 (N.D.Ill. 1986).

[8] *See* Hazen, THE LAW OF SECURITIES REGULATION §13.13 (1985).

mere insertion of a nonfrivolous claim in a pleading, motion, or other paper will permit escape from Rule 11. In the words of the Court of Appeals: "Whether meritless elements of a complaint combine to render the pleading frivolous as a whole is a 'matter for the [district] court to determine, and this determination involves matters of judgments and degree.' [footnote omitted]" (A-4). To entertain sanctions for *de minimis* violations, as Petitioner argues, will demean the litigation process to a far greater extent than do minor, but regrettable, pleading errors that are corrected before the courts or the litigants are put to any untoward effort.[9]

II. SANCTIONS ARE NOT WARRANTED UNDER 28 U.S.C. §1927.

Petitioner seeks sanctions under 28 U.S.C. §1927[10] on the basis of trial misconduct and the filing of a false debtor's petition in bankruptcy court by Robert Burull with the aid of counsel before this litigation began.

A court that finds a violation of §1927 "may" impose "excess costs, expenses, and attorney fees reasonably incurred be-

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[9] In fact the district court's verbal admonishments to counsel may be viewed as sanctions. Only the most callous member of the bar would not feel the sting of the district court's order and take heed. Rule 11 gives a district court a broad range of sanctions from monetary fines to a "warm friendly discussion on the record". *See generally, Thomas v. Capital Security Services, Inc.*, No. 86-4480, —— F.2d ——, sl'p op. 1588) (5th Cir. January 21, 1988) (en banc) ("Whatever the ultimate sanction imposed the district court should utilize the sanction that furthers the purposes of Rule 11 and is the least severe sanction adequate to such purpose"). *Id.*

[10] 28 U.S.C. §1927 reads, in part: "*Counsel's liability for excess costs*: Any attorney . . . who so multiplies the proceedings in any case unreasonably and vexatiously may be required to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct."

cause of such conduct." The language of the statute gives the trial judge express discretion whether to mete out sanctions, if a violation of §1927 is found. Because of its penal nature, §1927 has been strictly construed by the courts in reviewing cases in which sanctions are *granted*. *Indianapolis Colts v. Mayor and City Council*, 775 F.2d 177, 182 (7th Cir. 1985) (citing *Knorr Brake Corp. v. Harbil, Inc.*, 738 F.2d 223, 226 (7th Cir. 1984)). Accordingly, the courts have required a "clear showing of bad faith" in order for the penal sanctions of §1927 to attach. *Kamen v. American Tel. and Tel. Co.*, 791 F.2d 1006, 1010 (2d Cir. 1986) (citing *West Virginia v. Chas. Pfizer & Co.*, 444 F.2d 1079, 1082 (2d Cir. 1971), *cert. denied*, 404 U.S. 871 (1971)). Section 1927 has been reserved for the most egregious conduct.

The conduct adverted to in the Petition (at 5, 12) and in the district court's order (B-6) is generalized trial misconduct. While the court found the trial conduct "unprofessional", it did not find it conduct warranting a sanction. Without a trial transcript, Petitioner would have this Court second guess the discretion of the trial court and the court of appeals. The district court admonished Burulls' counsel for repeatedly attempting to elicit testimony ruled inadmissible and engaging in other conduct that unduly prolonged the trial, causing unnecessary delay, expense, and frustration. Beyond these generalized statements, there is no identification by the district court or by the petitioner of specific conduct warranting sanctions. The district court does not state or indicate that counsel's behavior was disrespectful, discourteous, or otherwise contemptuous. Petitioner has chosen not to provide a transcript of the trial proceedings and, accordingly, the district court's order finding this generalized misconduct not worthy of sanctions under §1927 is presumably correct. There

is simply no record on which to conclude that the district court abused its discretion in not meting out sanctions for trial misconduct.

Arthur Young also contends that it was an abuse of discretion in not meting out sanctions under §1927, after finding that the Burulls' claims were grounded on a false bankruptcy petition. The Burulls' claims were not grounded on a bankruptcy petition but on the wrongful conduct of Arthur Young and its codefendants. The bankruptcy petition is at most collateral to this proceeding.[11] "In any event, sanctions under §1927, unlike those under Rule 11, are discretionary, not mandatory." Court of Appeals, at A-5.

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[11] The bankruptcy petition contains a resolution stating that United States Satellite Services, Inc. is deadlocked; that the deadlock cannot be broken; that the resolution regarding the deadlock has been unanimously adopted by all shareholders entitled to vote. The district court found that "such resolutions in fact never existed and the evidence adduced at trial confirmed that Mr. Burull and his attorney knew such statements to be false." Petition, at B-4. The court did not find that the essence of the petition was incorrect. Apparently, no party objected to the filing of the resolution in Bankruptcy Court, which, as found by the court of appeals, has power to deal with such matters. Court of Appeals, at A-5, citing *Arkansas Communities, Inc. v. Mitchell*, 827 F.2d 1219 (8th Cir. 1987).

CONCLUSION

In summary, Petitioner asks this Court to consider questions of judicial discretion, which were carefully analyzed and correctly decided by the lower courts. Moreover, this Court is asked to review this case without benefit of a transcript. For the reasons stated above, the writ should be denied.

Respectfully submitted,

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February, 1988.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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INTRODUCTION

Rule 11 of the Federal Rules of Civil Procedure, which governs pleadings and motions, and 28 U.S.C. § 1927, which regulates generally the conduct of counsel in litigation, can together be powerful weapons to control all objectively unreasonable conduct in federal court litigation *if* they are invoked vigorously and uniformly.

This petition of Arthur Young & Company presents the Court with the opportunity to correct the lax and erroneous application below of both provisions and to speak to the lower federal courts and the federal trial bar

on the importance of the vigorous and uniform application of both.

ARGUMENT

I.

SANCTIONS MUST BE APPLIED WHERE, AS HERE, A VIOLATION OF RULE 11 HAS BEEN FOUND

The courts below found that respondents violated rule 11 in pleading two claims that had no legal basis and one with no factual support.[1] However respondents may seek to minimize those findings,[2] they undeniably indict, as violative of rule 11, the heart of respondents' pleading -- three of their four securities law claims, which provided the only basis for federal court jurisdiction.

Rule 11 says: "If a pleading . . . is signed in violation of this rule, the court . . . shall impose . . . an appropriate sanction." The question before this Court is

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1 *See* Appendix to Petition for Certiorari ("App.") at B5, 11 (the trial court found that respondents' claims under sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. § 77l(2) & q(a), "on their face, lacked merit," were "the subject of a sanction," and constituted "the technical violation of Rule 11."); A23 (the Eighth Circuit noted "the frivolousness of the allegation that Arthur Young had participated from the outset in a violation of § 10(b). . . .").

2 *See* Brief of Respondents at 4 ("The district court found only a 'technical' violation of Rule 11 . . ., which would not support Rule 11 sanctions. Hence, no Rule 11 violation has been found by the lower courts."); 7 (under Arthur Young's argument, "every pleading peccadillo would violate Rule 11 and sanctions thereby mandated.") and 9 ("[T]he violation was *de minimus* only and, accordingly, the violation does not support a sanction award under Rule 11.").

whether the rule means what it says -- that sanctions are mandatory when the rule is violated -- as four circuits and one panel of another hold, or whether the Eighth Circuit and a different panel of the Ninth are correct that sanctions are appropriate only when the entire pleading "itself is frivolous." *Burull v. First Nat'l Bank of Minneapolis*, 831 F.2d 788, 789 (8th Cir. 1987), App. A at A4, quoting *Golden Eagle Distrib. Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1540 (9th Cir. 1986).

Since this petition was filed the conflict among the circuits has deepened over the question of whether an entire pleading must be frivolous before sanctions under rule 11 must be imposed. The Fifth Circuit in *Thomas v. Capital Sec. Serv., Inc.*, No. 86-4480 (5th Cir. Jan. 21, 1988) (*en banc*), has joined the First (*see Quiros v. Hernandez Colon*, 800 F.2d 1 (1st Cir. 1986)),[3] the Second (*see Tedeschi v. Smith Barney, Harris Upham & Co.*, 757 F.2d 465 (2d Cir.), *cert. denied*, 474 U.S. 850 (1985)),[4] and the Seventh Circuits (*see, e.g., Frantz v. United States Powerlifting*

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[3] Respondents' effort to distinguish *Quiros* is unavailing because the First Circuit in that decision spoke directly to rule 11 in saying, "[W]e find no abuse of discretion," 800 F.2d at 3, in the imposition of sanctions where "the complaint contained both non-frivolous and frivolous claims." *Id.* at 2.

[4] Respondents argue that *Tedeschi* is not in conflict with *Golden Eagle* and *Burull* but they concede that one of the claims in *Tedeschi* was not frivolous. Thus, *Tedeschi* places the Second Circuit with those courts that, contrary to *Golden Eagle* and *Burull*, do not require that the entire complaint be frivolous before rule 11 may be invoked. *See* Petition for Certiorari at 9-10.

Fed'n, Nos. 87-1149 & 87-1223 (7th Cir. Dec. 31, 1987),[5] in ruling that where, as in the present case, a court finds "conduct to be violative of Rule 11, that court must then fashion an appropriate sanction in accordance with the dictates of Rule 11." *Thomas*, slip op. at 27. The Fifth Circuit added,

> There are no longer any 'free passes' for attorneys and litigants who violate Rule 11. Once a violation of Rule 11 is established, the rule mandates the application of sanctions. This appears to be the only construction consistent with the plain language of the rule.

Thomas, slip op. at 27.

Similarly, a panel of the Ninth Circuit in *Hudson v. Moore Business Forms, Inc.*, 827 F.2d 450, 456 (9th Cir. 1987), ruled in manner probably at odds with *Golden Eagle* and certainly at odds with the Eighth Circuit reading of that case: "[W]e do not believe that any number of sound

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5 Respondents attempt to distinguish a line of Seventh Circuit decisions supporting Arthur Young's position by singling out one phrase in one of the cases, *Szabo Food Serv., Inc. v. Canteen Corp.*, 823 F.2d 1073 (7th Cir.), *petition for cert. filed*, 56 U.S.L.W. 3416 (U.S. Nov. 20, 1987) (No. 87-828), which contrasts "serious" and "foolish" motions for sanctions, *id.* at 1084, and by trying to transform that comment into a holding that sanctions are not mandatory when rule 11 is violated. *See* Brief of Respondents at 7. Not only does *Szabo* not support respondents, but they totally ignore the Seventh Circuit decision which Arthur Young quoted at length for the proposition that "[r]ule 11 applies to *all* statements in papers it covers." *Frantz v. United States Powerlifting Fed'n*, (Nos. 87-1149 & 87-1223), slip op. at 8 (7th Cir. Dec. 31, 1987) (emphasis added), quoted in Petition for Certiorari at 10 n.6.

substantive theories explored in the pleadings excuse attorneys for providing reasonable legal and factual support for a damage claim."

Respondents attempt to add the Third Circuit to the courts which require that an entire complaint must be frivolous before rule 11 sanctions may be imposed. *See* Brief of Respondents at 6, quoting *Gaiardo v. Ethyl Corp.*, 835 F.2d 479 (3d Cir. 1987). If they were correct, that would only demonstrate even more sharply the split among the circuits, but *Gaiardo* never reached the issue and the Third Circuit has, in fact, not yet spoken on the question which this petition presents to this Court.

Thus, the split among the circuits has intensified as to whether an entire pleading must be frivolous before rule 11 applies and as to whether a finding of a violation of rule 11 -- whether as to all or a part of a pleading -- mandates the imposition of sanctions. Now is the time for this Court to resolve that conflict and impress the mandatory nature of rule 11 on the lower federal courts and the federal trial bar.

II.

SANCTIONS MUST BE APPLIED UNDER 28 U.S.C. § 1927 WHERE, AS HERE, OBJECTIVELY ABUSIVE CONDUCT HAS BEEN FOUND

In this case the trial court made specific findings as to the conduct of respondents' trial counsel which, by any

objective standard, was unreasonable and vexatious.[6] Respondents contend that this conduct does not reflect "a 'clear showing of bad faith' in order for the penal sanctions of § 1927 to attach." Brief of Respondents at 11, quoting *Kamen v. American Tel. & Tel. Co.*, 791 F.2d 1006, 1016 (2d Cir. 1986).

If, as we argue, section 1927 mandates the application of an objective standard of reasonableness similar to the objective standard applied under rule 11, *see* Petition for Certiorari at 11-12, that standard was clearly violated by respondents' trial counsel.[7] If there are cases, as respondents suggest, which apply a "bad faith" standard, this Court should resolve that conflict, reject such a subjective standard, and make clear that section 1927 requires the application of an objective standard of reasonableness. In this way both section 1927 and rule 11 will operate under a common, uniform and objective standard by which both trial conduct and pleadings and motions may be judged.

CONCLUSION

For the reasons stated above and in the Petition for Certiorari, Arthur Young & Company respectfully

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[6] *See* App. B at B6; Petition for Certiorari at 12.

[7] Respondents argue that this issue cannot be evaluated without reference to a trial transcript, which none of the parties obtained in this case. Brief of Respondents at 11-12. The trial court made very specific findings of misconduct which were never challenged by respondents or their trial counsel. Thus, no trial transcript is necessary to establish the unreasonableness of counsel's conduct.

requests that a writ of certiorari be issued to the Eighth Circuit and that this Court reverse the decision of that court in this case.

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New York, New York

Respectfully submitted,

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